The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta March 14th, 1946

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WITNESSES

E X H I B I T S

Corrections

CORRECTIONS TO VOLUMES 67 & 68

Page 5416 - Top line; "earn" instead of "burn".

Page 5428 - Delete "R.A." in front of the name Phillips Petroleum.

Page 5429 - In 5 places - "Monroe field" instead of "Mississippi field"

Page 5431 - 4th line - "measured" instead of "carried"; and last word in 5th line "pressure" instead of "price".

Page 5432 - Huntington Development and Gas Company.

Page 5445 - 3rd line; United Fuel Gas Company.

Page 5472 - "methane" instead of "methylene".

Page 5477 - Near bottom of page; "should daily run a minimum of 15 to 20 million feet".

Page 5489 - 6th line: "uncertainty" instead of "certainty", and last word 9th line "that" instead of "though".

Page 5518 - 11th line; "way" instead of "weight".

Page 5522 - Middle of page: "gasoline" instead of "gases".

Page 5535 - 6th line from bottom: "gas" instead of "gasoline".

Page 5536 - 10th line; "conserve" instead of "conserge".

Page 5550 - 10th line from bottom of page; "open flow instead of "overflow ".

Page 5564 - "Columbus" instead of "Columbia" - near middle of page.

Page 5566 - B.t.u. "quality" instead of "quqntity" - near middle of page.

Page 5572 - Just below middle of page: "in the Panola County".

Page 5620 - 9th line from bottom of page: "producer" instead of "purchaser".

Page 5624 - 10th line: "command" instead of "comman".

VOLUME 74

9.30 A.M. Session,
March 14th, 1946.

EDGAR G. HILL, recalled for direct examination by Mr. Chambers.

Q Mr. Hill, you have been sworn in these proceedings and are still under oath ?

A Yes.

Q On the instructions of Royalite Oil Company Limited I understand you have made an appraisal of the Company's absorption plant in Turner Valley and have made a report in that connection.

A Yes.

Q I would like to tender that, sir.

REPORT ROYALITE OIL COMPANY LIMITED, CALGARY, ALBERTA, CANADA, GASOLINE PLANT PRICEDAS OF NOVEMBER 15TH, 1943, NOW MARKED EXHIBIT 159.

Mr. Hill, you might read your report and deal with the figures either during the reading of the report or later as you see fit.

A The report is dated March 15th, 1945. It was made by me during March of 1945. It is entitled: "Report. Royalite Oil Company Limited, Calgary, Alberta, Canada. Gasoline Plant priced as of November 15, 1943." The letter of transmittal is dated Calgary, March 15, 1945 and is addressed to Royalite Oil Company Ltd., Calgary, Alberta, Canada, and reads as follows:

FORD, BACON & DAVIS
Incorporated

ENGINEERS
CONSTRUCTION VALUATIONS REPORTS MANAGEMENT

39 Broadway
New York 6.

Dear Sirs:

Pursuant to your request, we have made and

submit to you herewith, a valuation of the Gasoline Plant of your Company located in the Turner Valley field, together with a valuation of the Northern Return Drilling Fuel Line which is operated in conjunction with the Gasoline Plant. Plant property valued comprises the land, the structures and land improvements; the process equipment, the piping, valves and fittings, tanks pumps and instruments and laboratory equipment which were being used in the plant at the time of our examination in March 1945.

The material and labor prices used in the valuation are those current in the territory at November 15, 1943. However, in the application of labor costs, no effect was given to the relative inefficiency of labor due to wartime conditions, so that while the valuation does reflect current levels of material costs and construction labor wage scales as paid by your Company, it does not provide for those increased labor costs which, while a reality today, should disappear or diminish after the end of the war even though wage levels remain as at present.

Our valuation is summarized as follows:

	As of Nov. 15, 1943
Reproduction Cost New	$ 825,866
Reproduction Cost New Less Depreciation	638,647

The methods used in preparing the valuation and a detailed itemization thereof, are set forth in the attached report.

Very truly yours,

FORD, BACON AND DAVIS, INC.,

(Per: Edgar G. Hill)

Vice President.

M-1-3

Edgar G. Hill,
Dir. Exam. by Mr. Chambers.

REPORT

ROYALITE OIL COMPANY, LIMITED
CALGARY, ALBERTA, CANADA

GASOLINE PLANT

PRICED
AS OF NOVEMBER 15, 1943

March 15, 1945

As requested, Ford, Bacon and Davis, Inc. (hereinafter referred to as the Engineers) has made a valuation of the physical property of the Gasoline Plant of the Royalite Oil Company, Limited (hereinafter referred to as the Company), located in the Turner Valley field in Canada.

DESCRIPTION OF PROPERTY

The Gasoline Plant property included herein is located on approximately eight acres of ground near Turner Valley, Alberta, and has a capacity as at present operated of efficiently processing between 65,000,000 cubic feet and 100,000,000 cubic feet of Turner Valley natural gas in twenty-four hours, depending on the product being made. It is located adjoining the facilities of Madison Natural Gas Company Limited by which Company it is supplied with electricity and steam as required for its operation. The plant is of conventional design and construction, using oil as its absorption medium. All of the facilities are presently used, except two new steam turbine driven lean oil pumps which have not yet been put into operation but which are expected to be operable very soon and which will replace two steam pumps which are now in use but which will be removed when the two new pumps are started. These two steam pumps are not included in the valuation.

INVENTORIES

Preparation and Checking

Inventories were, with minor exceptions, taken by the Engineers assisted by Company employees. Inventories of certain mechanical items had been prepared by Company employees and were used by the Engineers as checking sheets. The length of buried pipe lines was obtained by ground measurement taken over the lines.

Northern Return Drilling Fuel Line

This is a gas pipe line averaging about 6" in size, extending from the Gasoline Plant about eleven miles to a point in the northern part of the Turner Valley oil field. Late in 1943, the Company purchased 18,032 feet of this line in place for $19,858.00, and itself built 39,284 feet. The Engineers have appraised this pipe line, less depreciation, at substantially what it cost to acquire and build in 1943. It is used to return natural gas from which the gasoline has been removed to producers in the northern end of the field.

Pricing

Prices of mechanical equipment items are either as obtained from Company vouchers covering recent purchases of similar items, by application of trend factors to known purchase prices in early years, or by consultation with suppliers.

Pipe prices are as shown by the most recent carload lot purchases made by the Company, and give effect to all discounts for quantity and prompt payment.

Labor costs are based on wage scales paid by the Company in the Turner Valley field in November, 1943,

assuming prewar labor performance and normal prewar overtime payment policies. No weight was given to excess labor costs due to abnormal overtime.

The unit costs used in the Valuation include cost of purchasing and warehousing, truck transportation from nearest railroad siding to job site, timekeeping, and foremen's supervision. They do not include any costs of surveying, engineering or designing by Company employees, nor do they include any allowance for administration or legal costs during construction, taxes and interest during construction, or contractor's profit. All Construction was assumed to be done by Company forces without profit.

All construction was assumed to be done by Company forces. In other words there is nothing in my valuation anywhere reflecting any contractor's profits for field work. That is the Company actually built the plant with its own forces and I have assumed it will be reproduced in the same way.

DEPRECIATION

All items of property except land were considered as subject to depreciation. When the gas in the Turner Valley field has been exhausted, the land occupied by the Gasoline Plant will no longer have value to its owner and will have been rendered useless for agriculture or grazing. The result will be that unless the cost of the land is taken into account in fixing the annual allowances for amortization of capital, the Company will never recover it.

I have put that paragraph in there simply to show that you must make some provision for the recovery of the cost of land. In the United States the Federal Power

Commission does not permit depreciation to be taken on land in fixing rates. In many cases passes injustice to the owner because the land he is using is usually spoiled for other purposes after he is through with it. But, while in this case the amount of the land is nothing, only a few hundred dollars, but still the principle is there just the same and I thought I ought to mention it.

The plant was carefully examined by the Engineers to determine as far as possible from exterior inspection, the amount of physical depreciation which had actually taken place in it. Likewise the annual physical tests made by the Provincial Boiler Inspector on the pressure vessels were examined. As a result of these examinations and of their discussion with the plant operators, the Engineers have concluded that the Gasoline Plant will have a total useful life of about forty years as is now reasonably indicated by the performance of the main units to date. The station, taken as a whole, was about ten years old at November 15, 1943, so that valued on the basis of life expectancy, the plant was then in about seventy-five percent of new condition, and should be operable, assuming normal maintenance, for about thirty years from November 15, 1943, barring major accidents. The accrued depreciation had therefore been estimated at twenty-five percent of the reproduction cost.

That basis of arriving at the crude depreciation is very similar to the method used and prescribed by the Federal Power Commission in valuing natural gas properties in the United States in that a life is assumed for the property based on general inspection and also based very often on the amount of gas which the plant or the property will be able to

handle. That is the amount of gas which is available to the property for handling. A total estimated life is arrived at in that way and the depreciation assumed to be the percentage of that total life which has already elapsed.

A part of the plant was moved from another location in the Turner Valley field and re-erected at its present location in 1943 and 1944, at which time all of the equipment moved was thoroughly inspected and any necessary repairs and renewals made to it.

That statement was made to me by responsible Company people, but I was there part of the time when that plant was being built and I saw what was going on with the old equipment and I am satisfied that the equipment moved from No. 2 plant to this plant we are talking about now, was thoroughly overhauled in the case of heat exchangers. The wearable parts were replaced and I saw the new parts when I inspected the building.

CONSTRUCTION EQUIPMENT CHARGES

The valuation contains an allowance representing an estimated charge for the use of construction equipment and tools which had not been provided for in the unit price.

TRANSPORTATION COSTS

The valuation contains an allowance representing the estimated cost of transporting workmen to and from the job in motor vehicles operated by the Company. The Company has been compelled to follow this practice in recent years. The transportation allowance is a cost which is unavoidable in these times due to wartime manpower scarcity and the rationing of gasoline and tires.

That allowance is one which would ordinarily not be required in the construction of a property not at least in the amount I have included. Some allowance is necessary at all times for transportation of people or else for a cost of maintaining a commissary where they can eat. I have followed the practice which the Company followed and have assumed the men would be transported, picked up in the field by trucks and transported to work and back in at night.

GENERAL OVERHEAD COSTS

As previously stated herein, general overhead costs, unavoidable in the construction of a property of this nature, have not been included in the unit prices for equipment, materials or labor. These general overhead costs include:

Administration during Construction
Legal Expenses during Construction
Engineering and Supervision during Construction
Interest during Construction
Insurance and Taxes during Construction
Damages in excess of Insurance during Construction

It has been the practice of the Company in the past not to capitalize such costs except that in some cases salaries of draftsmen and field engineers were capitalized. In making their estimates of valuation herein contained, the Engineers excluded all of such cost items from their unit prices. To construct a Gasoline Plant of the kind and size of that under discussion will require the attention of supervisory management and will require a field superintendent and a field supervisory and accounting organization set up for the purpose. The costs of such an administrative organization in a job of this size generally amount to at least two percent of its cost, including salaries and expenses.

The overall costs of engineering design

and supervision would normally be equivalent to at least three percent; legal services, insurance, taxes and damages during construction to one percent, and interest during construction would amount to about three percent, making a total general overhead cost equivalent to not less than nine percent of construction costs exclusive of general overheads. This rather low overhead cost presupposes a parent organization able to assign competent men to the work without the necessity of shopping around for them, and possessing sufficient credit to permit the new project to secure its construction funds without going into the financial markets.

In other words there is no cost of financing included in my overhead estimate.

That ends the text of the report.

The summary of valuation is shown on Page 11, classified by accounts. The first classification is land. I estimated that eight acres at $35.00 an acre. That is my own estimate which is based on what I thought the Company would have to pay for eight acres of land in that general area when they first came there in the early 1920's.

Structures. There are seven structures in the plant. Distillation building which is a large building and a shelter building which is a shelter built over the valves and level controls of the absorbers and a lean oil pump house which contains pumps and motors. Fire hall,office and tool house and shack for covering reclaimed oil pump . Another little shelter which covers unloading pump and a re-inforced concrete electrical distribution vault which houses the terminals of the electrical carrying cables which come over from the power house and also contains the switches and general

distribution fittings which lead electricity to the various places in the gasoline plant. The total structures amount to $43,885.00 new and $32,941.00 depreciated.

(Go to Page 5987)

The next heading is the Process Equipment. That classification includes reabsorber towers and all the heat exchangers, condensers, dehydrators, two stills, and that amounts to $263,616.00 new, and $197,712.00 depreciated. I examined all of those vessels and where there is anything subject to internal corrosion and carrying appreciable pressure, the records of the Boiler Inspector of the Province are available, and that gives you a more accurate picture of the internal conditions than you can get in any other way. They are all in good operable shape, and have been so considered. I want to say now there is no obsolescence in my opinion in that plant in any way. I examined a similar plant but very much larger, built in the last three or four years in Texas the other day, and it was the same, operated the same in principle and contained much the same kind of equipment that this plant does. In fact, some of the quipment was of the same manufacture and, generally speaking, it was all of the same type. The plant is of conventional design and, in my opinion, is thoroughly modern.

The next classification is Piping, Valves and Fittings. That has a very large amount of moneys involved in there and I personally counted, with some help from one or two of the company employees, all of the piping, valves and fittings of this plant. I priced them based on current costs as shown by Company books. I was unable, of course, to get the current cost of every item but I did get that of the principle items, and I interpolated between costs that I could get to arrive at costs of items of the size that were not shown on the books as having been recently purchased. I described every one of the items in the listing and the price that I used opposite each item. I added to my

list of quantities a small allowance for omission because some of the equipment was buried and I could not see it at all. That allowance amounted to, in the distillation building, to $1,879.00.

Q THE CHAIRMAN: What page is that on?

MR. CHAMBERS: Page 34.

THE WITNESS: Page 34.

THE CHAIRMAN: Yes?

A Nothing in the absorber building. That is the only allowance I made. That was the only building that contained lines where I was not certain I had seen it all, so that I made a small allowance there for omissions of 2%, as shown on Page 34.

Now, the total of all of the piping, valves and fittings in the plant is shown, a summary, on Page 21, which shows the total piping, valves and fittings new at $188,878.00, and depreciated $141,659.00. I estimated the time required to erect all that equipment, and on Page 44 you will see how I arrived at my daily labour rate, from $9.11 per day for 8 hours for a man. That is, I averaged the steamfitter and his helper and added for a foreman and for timekeeping, for payroll taxes and insurance, and that was $9.11 per day, which I used in both applying my estimate of the man-days required to instal that piping and fittings, and the amounts are set forth in each sub-heading. That is, in the distillation building I estimated 3000 man-days to instal the piping and fittings, which is a little less than one-third of the total cost, including the material. In the absorber building I estimated 800 man-days, and so forth. The estimates were made by me after carefully going over the

plant and are based on my experience and with plants of this nature, and with plants I have built, and I have knowledge which makes me competent to make such estimates.

The next classification is outside steam, oil, air, water and drain pipe lines. That is shown starting on Page 45. The total is valued new $33,192.00 and $24,894.00 depreciated.

The next item is tanks. There are probably 39 tanks in the plant and they are all described adequately, I think, in the list, and they amount in a total to new $87,384.00, and $65,538.00 depreciated.

The next item is pumps. The pumps are all described. They are mostly motor-driven, and there were a number of them steam-driven, but the large ones are motor-driven or turbine-driven, and they amount to $56,986.00 new and $42,740.00 depreciated.

The next item is instruments. Pressure recorders and so forth, a small amount, amounting only to $2,125.00 new and $1,594.00 depreciated.

The next item is laboratory equipment, and I have listed the main items, the main items are set forth, but there is a mass of small equipment which I have listed at the bottom of Page 61, which I did not make an aattempt to price, and detail, but lumped it, and the total laboratory equipment cost is $16,584.00 new and $12,438.00 depreciated.

On Page 62 you will find the valuation of the Northern Return Drilling Fuel Lines. In 1943 the Company put that in place at a cost of $80,945.00, and it was laid on the surface of the ground. They bought the pipe for $19,858.00 from the Major Oil Company, and I think from

my knowledge and from seeing the pipe, I would say they bought it at about the right price, and I included it at what they bought it for, on the depreciated side of the valuation. That was 18,032 feet of pipe. In 1943 the Company laid 39,284 feet of second-hand pipe, and which I priced in my estimate what it would cost to lay that line both for materials and labour, for six inch pipe new, including materials and labour, at $1.71 per foot. For six inch pipe used, $1.25 including labour, and for the other pipe, second-hand and new, 94 cents, making the total valuation of the line $80,945.00 new and $78,263.00 depreciated.

That is the total of the Report. I have already given the summary. And the valuation of that comes to $825,866.00 new, and $638,647.00 depreciated.

Q MR. CHAMBERS: Mr. Hill, in that connection I notice on Page 62 where you have the total cost new of the Northern Return DrillingFuel Lines at $80,945.00, and if you turn to Page 11, on the copy that I have, those figures are transposed, and show it as $80,954.00?

A Yes sir.

Q But Mr. McLellan tells me the figures are right in total so that it must be a typographical error?

A It must be a typographical error, I imagine. It should be $80,945.00.

Q $80,945.00 is the correct figure?

A Yes, that is the correct figure.

Q As I understand, the totals on Page 11 come out at that figure too?

A $9.00 is the amount involved.

Q Yes, $9.00?

A The figure is $80,945.00.

Q Now, Mr. Hill, this valuation was made as of November 15th, 1943?

A Yes sir.

Q Could you give us any idea as to what change by and large there would be supposing you were dealing with them today? As I understand, you have made some check?

A Well, I have. I would say that today some items would be cheaper and some items would be more expensive. The compressors and pumps, the mechanical items that come from the States, they all had a price increase since the 1st of January. If that increase has not been authorized, to any specific manufacturer now, I think that it will be authorized as soon as he can get his costs figured up under his new labour rates, because there has been a substantial labour increase granted in many basic labour industries in the States since the first of the year, and I think that some general increase in percentage will eventually apply to practically all plant labour before the year is out. In fact, I think it will apply in the next two or three months. That increase has generally been about 15%.

It will undoubtedly involve increases in manufacturing costs and increases in prices. I believe that the increases in pipe price in the States will be not less than $5.00 a ton. $5.00 has been allowed as the basic increase in steel. What will happen in this country I cannot say, but generally speaking pipe prices in Canada have followed pretty closely the pipe prices in the United States. But outside of the respective items in this property which have come from the United States, there would be no decrease in total this year for the prices as now for the prices I have used in the valuation. I have found that the price of Canadian items is pretty much frozen, so that I can say

definitely there will be no change in these prices.

Mind you, taking it as a whole, the plant would be valued today at about the same as I valued it in 1943. I understand that the Royalite Company has applied for an increase in its labour rates, which has not yet been granted, and when that increase is granted, if it is granted, the labour cost would necessarily be increased over the figures I have used, because I used the price which they used in 1943 and which they are using now.

Q Mr. Hill, assume with me this, previously, we will say, back in 1943, on importations from the United States there was a tax of roughly 10%, and that that tax is not now in existence, do I understand you to say that these other costs that you took are apt to increase?

A I think the cost of material coming from the States has increased sufficiently at this time so that it is, so that what I used in my valuation would take care of that tax situation.

Q And then, Mr. Hill, as I understand it, so far as Canadian made goods are concerned, being used in a certain way, I think it is for production or something of that kind, that there was a tax in 1943 that is not now in effect? As I understand, you made some check recently on that?

A Well I checked and found that ceilings which were in effect in 1943 are still in effect. If there is any change in the tax laws in here, in the tax situation in Canada, that is since the date I made the valuation, which has not affected the ceiling price, that is, if the ceiling prices are less taxes, then of course the Canadian price would be reduced by the amount of that tax. I am not familiar perhaps as much as I could be with that situation.

Q You have made a check of the ceiling prices?

A Yes.

Q But you do not know whether the ceiling prices are in effect?

A No, I do not.

Q That is all.

(Go to page 5994)

MR. CHAMBERS: Now just one question I would like to ask. The remarks you have just made as to the variation in the 1943 valuations, I would like to make it clear would that apply generally to the valuation you have made of the Madison equipment ?

A Yes, where the equipment is of the same type I think that my same remarks would apply because I used the figures as of the same date on the Madison appraisal. Both appraisals contain pipe and both contain pumps and I think generally speaking my remarks are applicable to both Companies.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. FENERTY:

Q Mr. Hill in connection with this northern return fuel line. I wonder if you could help me in something I am trying to think out. You know I take it that in sometime past when there were extensive drilling operations in the north end of the field that gas was being piped direct from one well to another well for the purposes of drilling operations. You know that ?

A That is common practice in most fields.

Q Just why would these operators in the north end of the field bother piping their gas eleven miles to the absorption plant and then eleven miles back rather than just to step across the fence ?

A Well they get as I understand it, the only reason that I can think of would be that they get a Royalty from the extraction of the gasoline.

Q And is that sound practice do you think ?

A Yes, I would say so. I would say it would not be sound to burn that gasoline as fuel.

Q It is sound economics to pipe the gas from these wells to the

absorption plant just to get the natural gasoline content ?

A Of course a good deal depends upon the rate of return that they get. I do not know the actual financial results to the operators but I presume it is to their advantage or they would not have done it.

Q Then it is good business to run this pipe line eleven miles down and eleven miles back in order to get the gasoline ?

A There was not any line run eleven miles down. That came down in the pipe that already existed.

Q I am talking about the extraction of the gas and you can take the man half way down, he pipes it six miles down and six miles back ?

A Yes.

Q It is a gasoline proposition ?

A It is a gasoline proposition.

Q And a straight gasoline proposition and nothing else ?

A Nothing else, no. Of course - -

Q Well - -

MR. CHAMBERS: Let him finish.

A There is no other reason. Gasoline was needed and the gas contained the gasoline and the Royalite was willing to process it.

Q MR. FENERTY: We will assume somebody wanted the gasoline and it is good business to them to take it or they would not do it ?

A Yes.

Q But that has nothing to do with the dry gas operations as far as the Canadian Western is concerned ?

A No, because the gas does not get past the gasoline plant. It is purely a gasoline operation.

Q Can you tell me one thing, we are hearing a great deal about the synthetic production of gasoline from natural gas. Would this absorption plant be a factor in that. Would it be used in connection with it ?

A Would it be used. I question whether it would be. I am not familiar with the design of the plant to make gasoline from natural gas by what you call the Fischer-trope process if that is what you have reference to. I cannot answer it. I do not think that it has. I do not think it would be incorporated into that sort of an operation.

Q And it follows then I suppose of course that you cannot tell me whether or not whether in any process of that kind it might be used ?

A That this gasoline plant might be used ?

Q This absorption plant would be an integral factor ?

A I cannot tell you, I do not know.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. STEER

Q One statement, Mr. Hill, on Page 4, you say the plant down here has a capacity as at present operated of efficiently processing between sixty-five million cubic feet and one hundred million cubic feet of Turner Valley natural gas in twenty-four hours depending on the product being made. I understand that to mean if they were making the 45 pound product the capacity is sixty-five million and if they are making the 26 pound product the capacity is one hundred million. Am I right in that ?

A I would say on general principles you are right. I do not know whether the 45 pound applies to the sixty-five million or the 26 pound applies to the one hundred million but as the

stripping is done less efficiently the more gas can be processed through the plant. It depends on what they are wanting. They can put one hundred million through or less to get a certain product. If they want a different product which takes more of the recoverable fractions out of the gas they cannot put as much through.

Q Quite so. You made your inspection in March 1945 and at that time the consolidation of the old No. 2 plant had been completed ?

A Yes.

Q With Plant No. 1 ?

A Yes sir.

Q We had some evidence here the other day of some two hundred thousand dollars worth of property left at the old No. 2 plant. Do you know anything about that ?

A I have not been out to the plant since the dismantling took place. I drove by it. I know there was property there in 1945 and I do not know what happened to it. Some of it I think was used at the No. 3 Compressor Station and some used at the No. 1 Gasoline Plant and some was left on the site.

Q You would not be prepared to say whether or not any of that two hundred and two thousand odd dollars worth of property was useful in any of the processes of the Royalite Absorption Plant?

A No, I could not say in detail what is there, I do not know.

Q That is all.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. HARVIE:

Q There was just one question, Mr. Hill. You were here giving evidence last year in connection with the valuation of the Madison plant. I think Exhibit 59 was that valuation. Did you

use the same figures and principles in valuing the gasoline plant as put in 159 as you used in the Madison plant Exhibit 59 ?

A I think I did, yes. I think I used the same identical figures where I could find an identical item. That is for instance the pipe. I think I used the same figure in each case and other items where they were the same items I used or should have used the same prices.

Q You gave the same factors consideration ?

A That is right.

Q So both these valuations were on a similar basis ?

A Yes, they were, or they were intended to be.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. McDONALD:

Q On Page 4, Mr. Hill the last sentence. I was just wondering. You refer to these two steam pumps which are not included in the valuations. Which two sets of pumps do you refer to, the new pumps or the old pumps ?

A The pumps that are included in the valuation are the new pumps. They were there but they had not yet been connected up. They were set on the foundation and I knew they would be connected up in a few days so I just used them and did not use the pumps that were temporarily doing their work.

Q Now with reference to the north return fuel line. I understand that line was laid on the surface of the ground ?

A The part bought from the Major Oil Company is I think - -

Q On Page 62.

A Page 62.

Q Yes.

A We will have to assume it is laid on the surface of the ground

for its entire length. I think that is a correct statement or substantially for its entire length.

Q Yes. That has been used for the transportation of dry gas, somewhat dehydrated I presume although the dehydrator is in the scrubbing plant ?

A The dehydrator is on the down stream side of the gasoline plant. I cannot say whether or not the gas that goes through this northern line has been dehydrated or not but I presume it has been.

Q And assume on the evidence that has been given to us that that line is actually going to be in use or has been and will be in use for a total period of forty months, three years and four months, what have you to say as to depreciation ?

A Well I think that the depreciation when the line is taken out of service, the amount that will be lost of course is the labour of laying that pipe. The pipe will have a substantial value. That pipe will be disconnected and moved into the warehouse and can be sold at a substantial price or used again. That is the only loss, will be the loss of labour.

Q Can you tell me what you calculated the labour in connection with that particular installation. There is no ditching or digging ?

A If I can get my Exhibit 59 I can. I can give it to you exactly.

Q There is your distribution there ?

A Thanks. The labour would be in the neighbourhood of twenty-five cents a foot, a line lying on top of the ground uncoated. I can give it to you exactly however I think. It was twenty-six cents. It was twenty-six cents.

Q Twenty-six cents, so that the unit cost that you show then of

a dollar twenty-five or a dollar seventy-one ?

A A dollar seventy-one is twenty-six cents for labour.

Q And then the dollar twenty-five pipe ?

A A dollar twenty-five.

Q That is practically the same size ?

A That is the same size. The pipe is worth about a dollar and the labour about twenty-five cents.

Q So it would be twenty-six cents off each one of these items of unit cost ?

A Each one of the six inch items. The four inch item would be perhaps fifteen cents off that.

Q Which would be the loss when the line was picked up ?

A Yes.

Q Yes ?

A Now the pipe would still have a substantial value.

Q In picking that pipe up, it is a welded line is it not ?

A It is a welded line.

Q And in picking it up that would have to be cut again ?

A It would have to be cut again, I would say it would be cut in double random lengths, forty foot.

Q Would the labour cost of picking it up be in the neighbourhood of twenty-six cents per foot again ?

A No, the labour cost in picking up a line, picking up that line would not be over - where it is not buried - one-quarter of the cost of laying it. Where it is buried we figure it costs half as much to pick it up but when the line is not buried we figure a quarter as much.

Q I suggest to you that the use for the forty months, the depreciation on that line would be approximately 10% on the forty year life basis ?

A Well you see I cannot give an answer to your question because I did not depreciate the new part of the line. It was just built in 1943. It was built new at the date I saw it and that is not subject to any depreciation as far as my figures are concerned.

Q I know.

A From an accounting standpoint in figuring costs depreciation should be used in later years. But it was new when I examined it and I could not depreciate it because it did not have any depreciation.

Q What I am trying to get at Mr. Hill is that that line will be picked up in the very near future and I am trying to find out from you if you can give us a figure on it as to how much it should be depreciated ?

A I would say there would be a loss there, oh in the neighbourhood of thirty-one or thirty-two cents due to picking it up and the cost of laying it in the first place which would have to be divided by the length of its life to get the annual loss. If it is going to be there - oh about five or six cents a year per foot. If it is going to last three years and ten months we have a total loss of thirty-one or thirty-two cents.

Q Then the pipe for future use or for use again would it be as good ?

A No, it would not be as good. It would be substantially as good but it would not be as good.

Q And would you agree that for the use it has been put to that it should be depreciated 10% ?

A 10% for its total life ?

Q No, 10% for the three years and six months ?

A That is all right. That would be very fair.

Q Would it be reasonable ?

A It would be reasonable.

Q And the salvage value would then depend on the market price for using the pipe after it was taken up ?

A It would depend on the market price. Actually Royalite would take that pipe and put it in its warehouse and use it in its own operation, that is what I think logically would happen. Its value would depend on the price of pipe at that time.

Q Mr. Hill, have you any information as to the actual use of this north return fuel line and the contract under which it was built ?

A No, I was told that that line was built to return to the drilling operators, oil operators in the northern part of the field, gas for them to use in their field operations after the gasoline was taken out.

(Go to Page 6003)

Q Now on page 5, Mr. Hill, under "Pricing", you refer to "Trend Factors".

A Yes.

Q Now that was an item discussed last year when you were here?

A Yes, it was.

Q Now do you recollect just roughly what you mean by the "Trend Factors?"

A Well the trend factors , the trend factor consists of multiplaying the cost of something, a piece of machinery, bought in 1935 by a factor to bring its new appraised value up to today's cost. Now those factors range between, generally speaking, between zero, for a piece of machinery which was bought in 1943 or 1942, and 30%. I would say where an item was bought in 1933 and 1934, that the trend factor I was using would be approximately 30% for a mechanical item.

Q And when you get the 1935, 1936 and 1937?

A As the years approach 1943, my trend factor declines. The trend factor I used for an item bought, we will say, in 1933, which was the lowest point on selling prices for mechanical equipment, and then it went up. After 1942 prices were almost standard. They stayed about the same.

Q My recollection is, or have you any recollection of using an average around 23%?

A I said that was the average that my 1939 valuation of the Valley Pipe Lines hadincreased. I used that figure, I remember in testimony, as applicable to that system. I would not want to see it applied here, but I would say that if you wanted to get an idea of how much this valuation of mine was trended up from the original cost as a whole, I can only give you a guess, because I have not done the same calculation. You see I did this calculation in the Valley

Pipe Line Company's costs as a result of a request and I have not made the same calculation here.

Q But you start with 30% in 1933 and progressively decreasing so far as, decreasing that factor until it reaches zero?

A In 1943.

Q In 1942?

A 1942 or 1943. That is for material. For the labour I did not use the trend factor.

Q Now with regard to this type of equipment, Mr. Hill, such as pumps, if this was discontinued in a year or two years, can you give me some idea what the salvage value of the equipment would be?

A The equipment, or the salvage value of the equipment, would be high, assuming that a user could be found for it, who could use it, but its value, that is to say, if you could use a pump built for 750 pounds, if you could use that pump for another service, this equipment would have a substantial value, and would have on an average, I would say probably 80% of what it cost. Some would have more than that, because it is new or practically new, but it should have a substantially higher value if a user could be found who had a use for it. As scrap it would be worth very very little.

Q Now, as I understand, the cooling towers and that type of installation, or a still?

A A still.....

Q No, cooling towers, are they of any salvage value at all, could they be moved?

A I do not believe we have a cooling tower in this plant, but a cooling tower can be used, yes, we tore some cooling towers down last year and shipped them to another plant. They bought them and they were pulled down and shipped. They have

a value but actually there are no cooling towers in the plant out here.

Q What I am thinking of, Mr. Hill, specifically is this, - we have some two hundred thousand dollars worth of investments in a plant which is equipment, a large part of it is equipment identical with the equipment which you have valued here, and it is no longer of use, and I am trying to think what value it would have as a salvage value?

A I think, I have not seen the equipment, but if you are referring to the #2 plant, I have not seen it, I have not seen it since that plant was shut down, I just drove by it and I noticed some things standing there, some parts of the plant, but what that value is I am not competent to say. You would have to get somebody to go out there and look at it and appraise it.

Q And then you would have to appraise it, having in mind a market in which it could be sold?

A That is right.

Q Now with regard to the depreciation, Mr.Hill, you fix the total life of 40 years for the plant?

A Yes.

Q Do you fix that having regard to the use of the plant or to the physical life of the property itself?

A I figure the plant will continue to operate, assuming normal maintenance, for at least 40 years.

Q Yes?

A Now that does not mean that everything in that plant will be there for 40 years, because some of it will be replaced. If it wore out it would be replaced with new, but generally speaking that plant 40 years from now would look pretty much as it does now, and many of the items would be still functioning,

but the over-all would have been about 100% replaced in 40 years. There would be a new plant there in 40 years through maintenance, but for this plant it would take 40 years for it to disappear through wearing out.

Q I notice on Page 7 you referred to "Use of Construction Equipment and Tools"?

A Yes.

Q Am I right that the total for that item is $3000.00 in your summary on Page 11?

A On Page 11?

Q On Page 11?

A That is all.

Q Yes. Then what tools and equipment did you have in mind?

A I had in mind the crane, the two sizeable concrete mixers and welding equipment, a wheelbarrow for the concrete, the tractor, two tractors probably, and the usual hand tools. Rigging. That is not the entire cost, that is just a charge. That is a fractional part of the cost of the equipment. The equipment would probably cost, oh I would say, it would probably cost in the neighbourhood of fifteen or eighteen thousand dollars. It is a moderate charge that a company would make for the use and depreciation of that equipment.

Q Yes. Well now, dealing with your estimate of man-days for installations of different pieces of equipment, take one for example, on Page 34, installation of pipe valves, and fittings, in the distillation building?

A Yes.

Q "3000 man-days at $9.11", was there any record in the Royalite Oil Company showing the actual man-days that had been used?

A No.

Q In that?

A No, there was not. The cost records were not readily available. I could have gone, perhaps, to all of the cost cars and worked out an approximation of what their cost records show for that plant, but I chose to make my own estimate, because this plant was not built in one operation. I may assume it would be built in one operation, but this plant was originally built in two places, and these buildings were all altered and enlarged as the new, as the plants were consolidated, and that made quite a disorderly calculation, you might say, for anybody to make if he were to attempt to figure out what the cost to build that plant would be, because you would have to be able to analyze the vouchers away back in those periods and find out what those men were actually doing, whether they were tearing down old buildings or building new, and I did not attempt to do that. I imagine that the extra man-hours for labour as shown in the Company's books would exceed what I have estimated, because much of the labour involved would be in tearing down and then reconditioning the equipment, and I did not make any allowance for that.

Q You based your estimate of man-hours on your experience of installations?

A Yes.

Q That you have supervised?

A That is right.

Q And on your knowledge of that?

A That is right.

Q With fairly efficient labour?

A And normal overtime. I did not figure any overtime practically there to speak of.

MR. McDONALD: That is all.

THE CHAIRMAN: Mr. Blanchard?

.....

CROSS-EXAMINATION BY MR. BLANCHARD

Q Mr. Hill, why did you prepare your appraisal on reproduction costs new less observed depreciation basis?

A Because I was asked to by Royalite.

Q I see. Now this part of the Inquiry we are engaged in now is to ascertain, or let us assume that is the purpose of it, is to ascertain the prices at which Royalite can buy raw material and still make a profit on its operations, - still make a profit on its operations, - that is I think practically what we are trying to get at. Now what factors would you take into consideration if you were trying to arrive at a proposition of that kind?

A I would take, - you are talking now about the physical plant to start with, with respect to the physical plant?

Q Supposing you are the general manager of a corporation, of an absorption plant, and you want to know what you can pay for raw material and still make a profit on your operations, what factors would you take into consideration?

A I would take into consideration the cost of the facilities which I had to build to process that material or to use in connection with the material because, if we are speaking about the physical properties, I would.....

Q I would like you to assume that the property, the facilities for manufacturing, have been there for 10 years?

A Have been there for 10 years?

Q Yes?

A All right. I think that the factors which would be taken into account in arriving at the costs of processing the raw material are, first, the costs of the property; second, the value of the property; and that value is, to my mind, reflected to a certain extent by reproduction costs. That is the only

reason that I would use reproduction costs, is because the value of the dollar has changed and a property built 10 years ago was built with a different kind of a dollar than the properties that are built today. If it were not so there would be no particular point in giving reproduction costs.

Q Now those are the considerations?

A We are talking now about the physical property?

Q Yes?

A Yes. I would want to know what the plant cost and I would want to know the reproduction costs of it.

Now as to depreciation, in the case of a wasting asset I am not particularly concerned about physical depreciation. I want to know how long the plant can stay there and do the job it is built to do, that is how long the raw material is going to last and I want to know if the plant will last that long, if it will last that long with normal maintenance, and that is about all I want to know.

Q All right, I see, and then having looked at all those things, if you found that your reproduction costs new today were so high that you could not make a profit,-you could not make a profit, - you would not go on with your operation.

A Well if my reproduction cost today was so high that I could not make a profit, I naturally would not build the facilities if I were.....

Q No, if I may interrupt, but they are already there.

A I know. I say I naturally would not build the facilities if I were starting fresh, but if they were already built I would pretty carefully investigate all collateral matters, having to do with costs, to see if any of them, other than the costs of the plant, could be affected, could be in any way modified.

Q Now we will suppose that, there is a competitive market for

the product of this absorption plant, let us assume that?

A Yes.

Q If you were endeavouring to find out what you could pay for raw material in competition with other plants, would you not take into consideration the capital that you had recovered since you commenced operations 10 years ago?

A Now.....

Q Through depreciation?

A No, I do not think that I should, no.

Q Why not?

A Because, - this gets down to pretty much of the theory of regulation, I think.

Q No, we are not under regulation, let us leave that out?

A You say you are not under regulation?

A We are not under regulation at all. This is just a proposition for you as general manager to know how much you can pay for raw material, and that you are not under regulation.....

MR. HARVIE: Do you mean that this contract is not under regulation?

Q MR.BLANCHARD: That the plant is not under regulation, and it is not coming under anything where you are making a rate base for rate making purposes?

A Well then, the laws, the ordinary laws and rules which apply to regulation do not apply here.

Q That is what I am suggesting.

A And I am footloose, in a free market?

Q Yes?

A Then the laws of competition govern me.

Q Yes?

A Of course they do. If not under regulation, and footloose with a free market, I am governed entirely by competitive laws.

Q Yes?

A Does that answer your question? Does that answer your question?

Q Well, what I am asking you is, under those conditions, where you are endeavouring to find out what you can pay for raw material and still make a reasonable profit, would you take into account your present investment in your plant, or would you take into account reproduction costs new?

A I think that depends, I would not take into account reproduction costs new, if my plant were built, as you say, and I am not under regulation, I am in a free market, I would then take into account what competition will let me have in the way of earnings, and I would capitalize that amount that it would let me have, and I would see how much value that would give me.

(Go topage 6012)

You see, when you are not depending on regulation and its limitation of profits, you are free to capitalize earnings you think you can make out of a certain venture, and that capitalized sum represents what you can afford to pay for the plant.

Q Yes, all right.

A Now, I do not think that I would particularly be interested in how much money there might have been set aside for depreciation in the past. That might not be enough or it might be too much. I would be interested in what I could make in a free market and then I would capitalize that at the percentage I thought that I ought to earn in that kind of a business, and that would give me my capital rate.

Q Yes. And then you can take anything over your fair or generaous rate of return and say, " I can pay that much for raw material"?

A That is right.

Q Yes. Now, if your plant originally cost you $400,000.00, let us say, and you have taken into reserve out of profits, actually taken into reserve out of profits, $300,000.00 of that, that is you have recaptured that much of your capital, then you can afford to pay more for raw material and still make a profit than you could at the beginning of the operation when you had an investment of $400,000.00?

A Well, your net book investment, of course, has been reduced.

Q Yes?

A And we are not talking about regulation now at all?

Q No, no regulation?

A You would have a much smaller book investment, there is no question about that.

Q And you can afford to pay more for raw material today because your actual investment is less, is that true or not?

A No, the actual investment is there. What the books show has been still unrecovered may be more or less. What you say is perfectly true, if my book value is less I can pay more for what I buy.

Q For your raw material?

A It is simple arithmetic.

Q You can pay more for your raw material in a competitive market and still make a profit?

A Yes, I can pay more in a competitive market and still make a profit on my residual book value.

Q All right, we will leave that, Mr. Hill. We were talking about the North Return Fuel Line, Mr. Hill. You, as a manager of a company, if you knew that the line was only going to be utilized for a matter of two years, or three years let us say, you would not make that investment at all unless you knew that you could amortize it out of your earnings inside of that length of time?

A No, I would not do it under ordinary conditions. That is right.

Q No. And proper management would demand that you amortize that in its lifetime, and not load the other part of your operations with the cost.

A I would have to amortize it over the useful life of that facility, the amount of money that was lost in laying it and picking it up together with the physical depreciation on the pipe itself.

Q Yes. And if you could not realize enough out of the earnings of the line within that length of time together with the return, you would not put it in there at all?

A From a strictly business standpoint, I would not, no.

Q Because if that were the case, you would be simply loading the rest of your plant for the remaining lifetime of it, with

an asset that had not paid?

A There might be reasons that would make me do it. I might take a lesser earning on that line, but, generally speaking, you are right in what you said.

Q As I understand it, you have not included any of the properties in the No. 2 plant in your appraisal at all?

A No.

Q Do you know why you did not do that?

A Well I was not asked to, for one thing.

Q You were not asked to?

A No.

Q Now, that plant has ceased to operate and it is not processing any of the gas in that area at all?

A The plant does not exist as a plant any more.

Q And for all practical purposes it should be written off as a loss?

A Well, what should happen to that plant is this, that if the remaining material out there, whatever it is, is down to scrap value, it should be scrapped. If it has a value in other parts of the Company's operations, it should be salvaged.

Q You would not take it into account if you were trying to find out what you can afford to pay for raw material in another plant?

A I think I would have to take it into account that is, if I had made substantial loss due to that plant being no longer usable, I, as a business man, would want to recover that loss somewhere if I could.

Q I see. By paying less for raw materials used in another plant?

A I am talking now not under regulation. If I were footloose and be able to pay what I thought best, be able to do what I think best rather, I would certainly try to get back some of that

loss.

Q Now, but suppose that you had some plant, at least that you put in additions that you contemplated would only be used for three years, the war years?

A The war years, yes.

Q Yes. And you were putting those additions into your plant because you were going to make a special product during the course of the war?

A Right.

Q Would you amortize those additions during that period of the war?

A Under those circumstances, yes.

Q Yes. And you would see that you made a contract that would do it rather than load the rest of the plant later with that cost when you were not making a profit?

A That is obvious.

Q Yes, that is obvious. What about salvage in the #1 Gasoline Plant, Mr. Hill?

A That is, the ultimate salvage value of it?

Q Yes?

A At the end of a 40 year total life, that plant would not have much salvage, because it would be substantially replaced with a new plant, assuming that the gas were to last indefinitely. Actually, the salvage that can be recovered from that plant at the end of 40 years, is a very small proportion. It would be a matter, if you want to figure salvage, as we generally do, at 5%, we do not know whether it would be 5 or 13 or 2 or what, but we use 5% as a figure picked out of the air, more or less.

Q I suppose it depends on the nature of the process that has been in use, that might not be economical?

A It is purely, as I see it, a guess which has obtained credence because the 5% is put down automatically as a salvage figure, but I do not think it has any particular value or validity. They just recognize the principle, that is all. That is all, thank you.

THE CHAIRMAN: Anything further, Mr.Chambers?

.....

RE-EXAMINATION BY MR.CHAMBERS.

Q Referring back, Mr. Hill, to Page 4 of your Report,Exhibit 159, to the 65 million cubic feet and 100 million cubic feet, and that is per day, 24 hours?

A Yes, for 24 hours.

Q Now, as I understood you to say to my friend, Mr. Steer, that when the plant is handling 100 million cubic feet a day, it cannot extract as much of the 45 pound product as it could were it only putting through 65 million?

A No, that is not right. It is the other way. When operating to extract a low vapour pressure product, it would pass more gas than it would to extract a high vapour product.

Q In other words, I just put it backwards to you?

A It depends what you want to make, how much gas will pass.

Q And which would be the higher for producing a 45 or 25 pound product?

A I cannot tell you that, because if I did I might be wrong. Mr. Stevens-Guille will tell you which is right.

Q MR. STEER: 45 pound pressure as against 25?

A The vapour pressure of a natural gasoline is the pressure which it exerts when it is in confinement as a liquid at a certain temperature. Now, if the larger quantity of gas is

processed, it would be my judgment that you would not get as much per unit of gas volume out of the gas as you would if you were passing a smaller amount of gas through. In other words, the processing is more complete when smaller volumes of gas are being passed.

Q MR. CHAMBERS: Yes. To build this plant in one operation, it would take from six to nine months, is that a fair estimate?

A I think that is a fair estimate.

Q Thank you.

THE CHAIRMAN: Anything further? Thank you, Mr. Hill. We will adjourn for a few minutes.

(A short adjournment was here taken).

.....

GRAHAM RADCLIFFE McLELLAN, recalled, already sworn, cross-examined by Mr. Blanchard, testified as follows:-

Q I wanted to deal, Mr. McLellan, for a moment with the allowance, or, at least the refund received from the Government by Royalite. I understand that $108,000.00 was returned?

A Approximately that.

Q That was pursuant to the provisions of Section or Paragraph 11 (b) of the contract, which is Exhibit 147?

A I will assume that. I do not know.

Q It represents 60% of the expenditures made?

A 60% of certain expenditures.

Q Certain allowed expenditures?

A That is right.

Q As I understand, your total expenditures relating to the consolidation of the plant and the additional equipment installed for the purpose of obtaining the product from which

iso-butanes are obtained, were altogether $234,507.23?

A Well I have not got that figure.

Q You can assume that for a moment. I will refer you to the exhibit, So that the Government in paying you $108,000.00 assumed that you had installed $180,000.00 of equipment which would have no permanent value?

A That is the amount of money which was settled upon between ourselves and the Government under this contract.

Q Yes. You have no expectation that the Government will ever ask you to return that have you?

A I have no idea.

Q Well, in the meantime how are you treating that $108,000.00 what are you doing with it?

A It is just held as a suspense item in our plant investment account.

Q Are you investing it in any way?

A I think it is just shown in the general funds of the Company.

Q Any reason why it should not be invested in Victory Bords, for instance?

A Well, it goes into the general funds and then I don't know where it is.

Q It is in your general funds now, it is not in any special account at all?

A No, not in any special account. There is a record kept of it, of course, on the credit side.

Q And don't you think that that amount should be deducted from your capital investment at this time?

A I do not think so.

Q Pardon?

A I do not think so.

Q Pardon?

A I do not think so.

Q You think not? All right. When that contract was made with the Government, perhaps I had better refer you first to Page 6 of your submission. On Page 6 of your submission you say "Estimated Future Operating Results, 1945 to 1948 inclusive"?

A Yes.

Q "Revenues. These are calculated by using the estimated gas to be processed, which is shown in the Madison Natural Gas Company Limited submission M-2(revised). It is assumed that the present product will not be manufactured after the end of 1946."

A Yes.

Q "If such is the case, the number of barrels recovered from a certain amount of gas will be less than in the years 1945 and 1946." I take it that that is tantamount to saying that the installations you had prior to 1943 would have been adequate to take care of your absorption operations after 1946?

A I do not know.

Q Pardon?

A I do not know.

Q Well, you will no longer be endeavouring or trying to extract the heavier product?

A We will be making a different product.

Q You will be making a different product?

A Yes.

Q The same product that you used to make ?

A I don't know whether it will be the same or not.

Q I see. In any event, you have represented to the Government

that you spent $180,000.00 for installations that have no permanent value, because they were put in for the express purpose of obtaining iso-butane?

MR. CHAMBERS: Where have we represented that? I would like to know where you get that information.

MR.BLANCHARD: I take it you did represent it to the Government when you asked the Government to pay you back 60% of the $180,000.00.

MR. CHAMBERS: No, we made no such representation.

Q MR. BLANCHARD: On what basis did you get back $108,000.00 then?

A You are asking me?

Q Yes?

A In accordance with the contract with the A. W. S. C.

Q All right. Let us look at it. Does that contract entitle you to return of any money from the Government that is of permanent value for your future operations?

A I am not very familiar with that contract, Mr. Blanchard.

(Go to page 6021).

Q Then all right, assuming that what you say is right on Page 6 where I read from do you not consider it would have been proper for you and that you should amortize that expenditure of $180,000.00 over the period from 1942 - 43 to the end of 1946?

A Would you repeat that last part ?

(By the Reporter reading)

Q Do you not consider it would have been proper for you and that you should amortize that expenditure of $180,000.00 over the period from 1942 - 43 to the end of 1946 ?

A No, I do not think so.

Q And that it should have been written off by that time ?

A No, I do not think so.

Q Why not ?

A Well there are certain installations there and I do not think anybody can actually tell whether the equipment itself has any value at all at the end of 1946, I think as you would infer if I wrote off all that in that short time.

Q In your submission you say by 1946 you will not be manufacturing or processing this heavy product, producing this heavy product ?

A That is right.

Q And you will be going back then to the situation that existed before you put these installations in ?

A I do not think I said that.

Q Well is not that what it means ?

A No, I think there have been certain installations made in this plant and they may or may not have got any use after 1946.

Q You say that you are not going to manufacture this product for which these installations were put in ?

A No, I do not think I said that.

Q After 1946 ?

A I do not think I said that.

Q Well let us read it again.

"It is assumed that the present product will not be manufactured after the end of 1946."

A Yes.

Q That is the assumption on which your figures are based ?

A That is right.

Q That is correct is it not ?

A Yes.

Q If that is the case the installations that were put in to produce that product will not be of any value to your plant after that time ?

A I do not know whether they will or not.

Q You do not know ?

A No.

Q Somebody does though ?

A I do not know.

Q THE CHAIRMAN: You have not yet answered Mr. Blanchard's question, assuming that you are not going to make that product after 1946 ?

A Yes.

Q Mr. Blanchard asked you if it would not have been proper for you to amortize that cost of $180,000.00 over the period during which the product was being made and which you are not now going to make ?

A No, I do not think it would have been proper.

Q On this assumption ?

A Yes. Even on that assumption I do not know that that particular equipment is of no further value from the end of

1946 onward.

Q As a matter of business precaution would not that be the proper thing to do to amortize it over the period during which you made that product ?

A I should think you would probably have to get engineering advice on that.

Q As a matter of accounting would it not be proper accounting practice ?

A After I had engineering advice.

Q MR. BLANCHARD: Let me put a home made example to you. Suppose you had a mail truck between here and Red Deer ?

A Yes.

Q You use a truck to deliver mail - perhaps Red Deer is on the railway line and it is a poor example, but just assume that - and a contractor who was doing a job in Red Deer comes to you and he says: "I have a job that will take six months".

A Yes.

Q "I would like you to put seats in your mail truck to carry my labourers to the contract job during that six months."

A Yes.

Q And you and he make a price on that. Now would you consider it was proper, reasonable, and only good business sense to amortize the additional cost because of fixing up your truck to take care of those men over the six months, over that six months period ?

A I would look into any future possibilities, that is if I could probably get another contract of the same nature a little later on.

Q Assuming that there was no such other contract ?

A If there was no such other contract, yes I would agree with

you.

Q No such contract in sight or any likelihood of one ?

A If there was no further use of these same seats under any circumstances I think I would agree with you.

Q You would amortize it over the six months ?

A Yes.

Q And you would get a price that would pay for them in that six months on your contract ?

A That is right.

Q That is correct, all right. Do you see any analogy between that situation and your situation with relation to putting in the installations in order to make the heavy product during the course of the war ?

A There is a relation but I do not think they are similar.

Q In what way are they dissimilar ?

A I do not know, where as you told me to assume that the seats were of no further use and I do not know that this equipment is of no further use.

Q Well who does know ?

A I cannot tell you.

Q Is there anyone in the Royalite Company who would know that ?

A I do not know.

Q Were any representations made to the Government at all when you submitted your figures to them to get the refund ?

A I do not know.

Q Who would know. Did Royalite ask for a refund of 60% of $234,000.00 or 60% of $180,000.00 ?

A $181,000.00 was agreed upon.

Q What ?

A I think $181,000.00 was agreed upon.

Q Agreed upon by whom ?

A I do not know.

Q By whom on behalf of your Company ?

A I do not know.

Q You say it was agreed upon ? Agreed upon as being extraordinary expenditure ?

A Just the figures is all I am talking about.

Q All right. Now then this north return fuel line. You amortized that over some forty months ?

A Yes.

Q Because there will be no further use for it ?

A I had engineering advice to that effect, yes.

Q You have not had any engineering advice on the other matter I have been discussing ?

A No, I have not.

Q Let us go to the No. 2 plant. In your submission here you are carrying into your capital investment, for the purpose of ascertaining the profits and so on, you are carrying into your capital investment something in the neighbourhood of $190,000.00 for the No. 2 plant. The exact figure I have not got before me. I think it is $187,000.00.

A $205,000.00 is it not, less $61,000.00 depreciation ?

MR. CHAMBERS: It would be about $140,000.00 would it not ?

A Schedule "J".

Q MR. BLANCHARD: $149,934.98, that is June 1945 ?

A On Schedule - -

Q Statement 6.

A $149,000.00 - 1945.

Q Does that include this reactivator ?

A The refractionator.

Q Probably the same thing, I would not know ?

A I would not know either.

Q Does that include that item ?

A Part of it, yes.

Q What ?

A Part of it.

Q Is there anything to add to that figure I have given you for capital investment in Gasoline Station No. 2 ?

A You could take into account the compressor plant No. 2 which is the same location.

Q That is nearly $15,000.00 more ?

A Yes.

Q Now you are loading all that cost on to your future operations in Gasoline Plant No. 1 ?

A In Gasoline Plant No. 1, yes.

Q You are never going to take any more gas into No. 2 plant because it is not there ?

A That is right .

Q And the reserves that used to be available to the No. 2 plant have been added to the reserves of the No. 1 plant ?

A That is right.

Q And that has prolonged the life of the No. 1 plant to the extent of those additional reserves ?

A I do not know as it has prolonged the life. I think probably the reserves would have lasted just as long but might not have been as high.

Q Well you are going to use up in the No. 1 plant in the future those reserves that were available to the No. 2 plant ?

A Yes.

Q And at the same time you are going to use those same reserves

in amortizing the valuations or the capital investment in the No. 2 plant ?

A Yes.

Q You are going to use them in two places ?

A Two places with one investment.

Q They have been taken away from the No. 2 plant and they have been added to prolong the life of the No. 1 plant and you are going to amortize the No. 2 plant on the assumption they are still there ?

A No.

Q Those reserves are still there ?

A No.

Q Yes you are ?

A No, I just assume I have certain monies here which at present do not appear to have any particular value and probably they have been, undoubtedly I should say there has been a loss incurred. Now the Royalite Oil Company had certain monies invested in this gasoline department and I think they would certainly like to recover them in the future operation.

Q Can you say that they have not already been recovered ?

A I do not think they have been recovered.

Q What do your books show ?

A The books show we have certain assets and certain depreciation reserves.

Q Do your books show that the plant No. 2 is almost completely written off ?

A Yes.

Q What ?

A They do.

Q Do you know or do you not know whether actually there was

received in earnings sufficient to write that off during that period and also give the Royalite a fair rate of return ?

A That would be from 1935 on ?

Q From 1935 on.

A From the start of operations, yes. No, I do not know that.

Q Can you find out ?

A I could find out.

Q Do you think it is important to find out or not ?

A Well of course you have to then take into account what would be a fair profit.

Q All right. Let us take into account what would be a fair profit. You can ascertain then whether since 1935 there have been sufficient earnings from that plant to return a fair profit and write off the plant ?

A I would not like to say myself what is a fair profit.

Q No, but could you find it out ?

A I do not know where I could find it out.

Q It is not possible to ascertain it ?

A I could find what the profit was, using certain methods of depreciation. Whether or not that is a fair profit I do not think I am qualified to say.

Q You can at least find out what the earnings were ?

A I could.

Q Now during all the years that you have been operating these two plants you have been getting your gas from various persons who have invested a lot of money in wells throughout this Valley ?

A Yes.

Q And for some years, a number of years, you paid them on the basis of the charcoal test ?

A Yes.

Q In recent years you felt that was not fair and you have paid them on the actual amount of gasoline recovered ?

A The procedure was changed.

Q Well am I stating it correctly ?

MR. CHAMBERS: How does he know whether it is fair or not or is that the reason they changed. He said it was changed.

Q MR. BLANCHARD: I said in recent years you have been paying them on the basis of the actual gasoline recovered, is that right ?

MR. CHAMBERS: He agreed with that but you said they did it because they thought it was fair.

Q MR. BLANCHARD: I see. Referring to your Statement No. 2 in 1939 the share to the producers in Gasoline Plant No. 1 is given as $31,784.56 ?

A 36 cents.

Q $31,784.36.

MR. CHAMBERS: What page ?

MR. BLANCHARD: Statement 2. The second line of Statement No. 2. Less share to producers your total recovery there was two hundred and three thousand odd dollars ?

A Our total sales were two hundred and three thousand odd dollars.

Q Total sales ?

A Yes.

Q All right. That is a percentage to the producer of 15.6% ?

A I will assume that.

Q All right. I submit that is correct. That is 1939. In 1940 the share to the producer was 17%. I am just putting these in for the record and I am referring to the second line of Statement 2. In 1941 it was 17%, in 1942 it was 15.8%, in 1943 it

was 13.6% and in 1944 they received the full 20% share of what you recovered ?

A 20% of the production.

Q 20% of the dollar return ?

A No.

Q Well 20% of what ?

A 20% of the production at the price in effect at that time.

Q They got 20% of your proceeds of sales of gas ?

A No, they did not.

Q What did they get ?

A They got 20% of the production, valued at the price current at that date. I will go a little further than that and say there is a line loss Mr. Blanchard in bringing it from Turner Valley to Calgary and the Royalite Oil Company themselves have to absorb that or do absorb it I should say.

Q They absorb that do they ?

A Yes.

Q Did they always absorb that ?

A I do not know, but at present they are doing that.

THE CHAIRMAN: I thought the Valley Pipe Line got the allowance for line losses ?

A Well it is taken up in the price.

Q MR. BLANCHARD: Now was there any different contract entered into in 1944 with the producers to the contract that was in force prior to 1944 or was it the same contract you were operating under ?

A I cannot tell you.

Q Can you find out ?

A Yes.

Q Now then taking the figures I have mentioned, I find that the producers' average share for the five years, I have referred to, is 15.37% and not 20%;

Then going to Statement, or to Gasoline Plant No. 2, which is Statement 3 ?

A Yes.

MR. HARVIE: Will you give me that 15.37% again, what is that ?

MR. BLANCHARD: That is the average.

MR. HARVIE: The five year average ?

MR. BLANCHARD: The five year average.

Q MR. BLANCHARD: And then Gasoline Plant No. 2 is found on Statement 3 and there I find the same thing to obtain.

MR. HARVIE: May I interrupt again, in that statement there are six years, which five are you using ?

MR. BLANCHARD: 1939 to 1943, that is five years.

Q MR. BLANCHARD: I find that the average share of the producer was 15.9% and I take it that no adjustment has ever been made of that difference ?

A That change was made in November 1943 and the plant closed on October 31st, 1943.

Q All right. Now I want to go to another matter and that is the compensation which was paid by Royalite under order of the Conservation Board.

Q MR. STEER: Before you leave that, could I get the dates on which you began to pay the 20% ?

A November 1943. There was no specific date but it was for that month's production.

Q Prior to that it was on a different basis ?

A That is right.

Q MR. BLANCHARD: Prior to that it was paid on the basis of the charcoal test of the well ?

A That is right.

MR. CHAMBERS: I am not going to give evidence on this but I would like to mention it, my information is that those contracts were not all 20% contracts.

MR. BLANCHARD: Oh, I was assuming that they were not.

WITNESS: No, that is correct, Mr. Chambers. There was the odd one which was 12½.

Q MR. HARVIE: So all payments made in connection with Plant No. 2 was on the charcoal basis and not on the 20% ?

A That is right. Not on the proceeds of production. The charcoal test was arrived at and so many barrels at a certain price was then divided by, either by five or by eight, depending on whether it was a 20% contract or a 12½% contract but the whole procedure was the charcoal test.

Q MR. STEER: Will you, Mr. Chambers, furnish us with the number of contracts and what they are ?

MR. CHAMBERS: I will.

Q MR. BLANCHARD: I am going on to this compensation fixed by the Conservation Board, that is where Royalite was required by reason of over production of the gas cap, to pay to well-owners a hundred and ninety-six thousand dollars ?

A Approximately.

Q And as I understand it, Royalite itself received out of that for its crude wells, thirty-two thousand, or sixty-two thousand rather ?

A Approximately.

Q Actually sixty-four thousand ?

A Approximately sixty, I am not just sure of the odd amount.

Q Sixty-four thousand dollars ?

A It is approximately sixty. I do not know just what it was.

Q Can you ascertain what it was ?

A I can.

Q And that left a hundred and thirty-two thousand that was paid to other well-owners ?

A That is right.

Q And out of that you have charged to the Royalite gasoline division ninety-six thousand ?

A Yes.

Q And how was the other thirty-six thousand dollars allocated ?

A Well probably you should start right at the first payment, the, one hundred and ninety-six thousand five hundred and eighty-four dollars and some odd cents was paid personally to the Conservation Board and then they paid it out. Of that charge now, we charged ninety-six thousand of that to the gasoline plant and approximately the same amount to the gas division of our business and a small portion to the crude oil department. Now that is the payment. Then we received back from the Conservation Board some sixty thousand dollars which was credited to our crude oil department.

Q Yes, well you paid sixty-four thousand dollars out to the Board and got it right back again ?

A Yes.

Q Did you charge part of that to the gas division ?

A To the gas sales division.

Q I mean, the sixty-four thousand which you paid out and got right back, did you charge that to somebody ?

A Well we charged it in the manner in which I have stated.

Q What ?

A We charged the payment in the manner in which I have stated.

Q You charged 50% of that to the gas division ?

A Approximately 50% of the one hundred and ninety-six thousand, yes.

Q And why did you charge it on a 50-50 basis ?

A Oh, I do not think it was a 50-50 basis.

Q Well it is 50% to the gasoline division and 50% to the gas division, is that correct ?

A Well the figures happen to work out approximately 50%.

Q How did you come to do that ?

A Well this payment was made under a settlement which we made with the Conservation Board.

Q Yes, but they did not allocate that the gas division was to pay so much and the gasoline division was to pay so much, Royalite was charged ?

A I think they did, sir.

Q What ?

A I think they did.

Q Oh, they did. Perhaps Mr. Morrison can tell us that some time; that was the way it was done anyway, the Conservation Board said that the gasoline division should pay ninety-six thousand ?

A No, they said the Royalite Oil Company should pay.

Q That Royalite Oil Company should pay a hundred and ninety-six thousand dollars ?

A That is correct.

Q Is that right ?

A That is right.

Q And who allocated those charges as between the gasoline division and the gas division ?

A I did myself.

Q You did yourself ?

A Yes.

Q And on what basis did you make that allocation ?

A On the same basis as the statement was submitted to the Conservation Board.

Q And by whom were those statements submitted to the Conservation Board, by Royalite ?

A By Royalite.

Q Yes.

A Yes.

Q And in submitting them to the Conservation Board Royalite said 50% of this cost should be taken by the gasoline division and 50% by the other, is that the way it was done or how, or was it on the basis that the gasoline division has made 50% of this money and the gas division has made 50% of this money, is that the way it was done ?

A There was a settlement made.

Q What ?

A There was a settlement made.

Q I know there was a settlement made but I am trying to get at how this money was allocated ?

A It was allocated under a mutual agreement between ourselves and -

Q Between yourselves ?

A Between ourselves and this Conservation Board.

Q No, between yourselves and yourselves, between yourselves, allocating something to the gas division and something to the gasoline division ?

A Well firstly, the amount was arrived at, the one hundred and ninety-six thousand was arrived at between the two parties.

Q Yes.

A And certainly - -

Q And what was the hundred and ninety-six thousand, did it represent a profit that was made by Royalite out of its operations that it should not have made, is that the basis of it, or that it would not have been made if it had not operated beyond your allowable, I will put it that way ?

A No, I do not think it was either, sir, I think it was just a straight settlement.

Q A straight settlement ?

A Yes.

Q There must have been some basis of the settlement, do you know or don't you know ?

A Yes, I prepared all the statements and I know all the details.

Q THE CHAIRMAN: Did not the Conservation Board issue an order ?

A They did.

Q Telling you what you should pay ?

A They did, sir.

Q And in that order did they tell you how you were to allocate the amounts you were ordered to pay ?

A I cannot say definitely whether it did or not, but we were asked for certain information which we gave to the Conservation Board.

Q Well, Mr. McLellan, let us know about this, the Conservation Board was holding a hearing and your Company was represented by Counsel ?

A Yes.

Q It was not settled. It was after a hearing, that the Board arrived at the figure and ordered it to be paid ?

A Yes, and I say that the method which the Board used or agreed upon with us, was to take those three divisions which I mentioned, the gas division, the gasoline department division and the crude oil division.

Q All right, Mr. McLellan, I am going to ask you to produce a copy of the Order made by the Conservation Board and then we will know what it says, will you do that ?

A I think I can, sir.

Q MR. BLANCHARD: As a matter of fact - -

A Pardon me, sir, I think there were certain amendments to that. I suppose we should have them all.

THE CHAIRMAN: Yes.

Q MR. BLANCHARD: Now all this compensation was because Royalite had produced its gas-cap wells to furnish the gas required in the Calgary market ?

A Because Royalite - -

MR. CHAMBERS: Pardon me, if we are going to get the Orders now, should we not have those and not have the witness giving the whys and the wherefores ?

MR. BLANCHARD: I want it in broad terms, why there was any order.

MR. CHAMBERS: I do not mind you getting his idea of it but I do not want you to take it as the final say on it.

THE CHAIRMAN: And also bring the Order-in-Council whereby the Government authorized the Conservation Board to conduct those enquiries, bring that too and then we will know why.

Q MR. BLANCHARD: Mr. McLellan, is it not a fact that none of that should be charged to the gas plant division of Royalite as such, that it all should be charged to the crude oil operation, at least to the well operation ?

A I think you have to go through the whole Conservation scheme and orders to arrive at that opinion.

Q Now let us assume that the gas-cap wells had been owned by Richard Smith of New York City and not by Royalite, but that the absorption plant was, and the residue gas system, was operated by Royalite, - then Richard Smith would have been the person who had to pay the compensation for over-production of his gas-cap wells, I am correct about that ?

A That is right.

Q Eh ?

A That is right.

Q Yes, and Royalite would not have had anything to do with it at all so far as its absorption plant was concerned, would it ?

A I do not know.

Q And would not have had anything to do with it at all as far as its residue gas is concerned ?

A I do not know that either.

Q You do not know that either ?

A No.

Q If that is a fact, then none of this should be charged to anything but the well operation account, am I correct about that ?

A I do not think I can answer that.

Q All right. Now there was something which I think should be cleared up, which you said in your examination on Monday and it is at Page 5901, where something was referred to by the Chairman when you were being cross-examined by Mr. Steer and I think you let it be understood, or possibly you did not intend it to be, - that the income tax branch takes no account of earnings at all.

MR. CHAMBERS: No what, no account of what ?

MR. BLANCHARD: No account of the rate of return.

WITNESS: Would you mind reading what I said.

Q MR. BLANCHARD: Yes, I will read it. It is on Page 5901. Perhaps I had better go back, near the top of the page:

"Q If you are examining the account of any ordinary industrial undertaking, Mr. McLellan, and you are determining earnings your earnings are taken on the historical cost of the capital employed plus additions, less items discarded and less depreciation, for the purpose of ascertaining the percentage earnings of the Company. Is that right ?

A Including working capital.

Q Including working capital but my point is that in determining earnings the depreciation reserve is always deducted from the amount of the capital employed ?

A Usually.

Q That is the scientific accounting way of doing it, is it not ?

A Oh it is done other ways I understand.

Q You understand. Perhaps you will tell us about your understanding ?

A Well they are just rumours, I do not know of any specific cases.

Q Well if it is only rumour we do not need to pay any attention to rumours.

THE CHAIRMAN: We are not certain what the income tax people do.

A I do not think they determine rates of return to any extent.

Q But the deduction of depreciation from the capital value

of the assets in computing your profits ?

A Well they take a portion of that capital asset. They do not deduct anything from the asset."

Now the approach to the matter is that in dealing with excess profits the depreciation taken from year to year is taken into account ?

A Yes.

Q That is true, is it not ?

A Yes.

Q And in fixing your standard, your "standard profits" I think that is the expression ?

A That is it.

Q Your rate is taken into account, is it not ?

A The rate of earnings.

Q Yes, or the rate of return ?

A On the capital employed.

Q Yes, as booked ?

A As "sustained by the Income Tax Department" and I think I meant to say that but I just didn't, somebody interrupted me probably and I just finished the sentence. I meant to say that.

Q How do you want to express it ?

A I meant to express it, I do not think they determine the rate of return to any great extent, with the exception of the excess profits tax.

Q Just describe to us what is done under the excess profits tax position, under the Excess Profits Act ?

A It is a long time since I read the Act.

MR. CHAMBERS: Probably you should in fairness put the Act before him.

MR. BLANCHARD: Which ?

MR. CHAMBERS: Probably it would be as well to put the Act before him.

Q "Deductions from profits" and that is Section 3, profits as hereinbefore appearing, subject to the following deductions, and (b):

"Deductions of the total amount of depreciation which since the first day of January one thousand nine hundred and seventeen, has been or should have been taken into account in accordance with the practice and regulations of the Income Tax Division of the Department of National Revenue in ascertaining profit or loss."

And so on, that is your understanding ?

A That is right.

Q And you did not intend to say what you did ?

A No.

Q At this stage ?

A No, I say "return to any extent", well I meant the Income Tax Department did not do that "to any great extent".

Q By the way, I think you intimated that this whole one hundred and ninety-six thousand dollars was charged, so far as Royalite was concerned internally, about 50-50 against gas and gasoline?

A Approximately, yes.

Q And was anything charged to the production department ?

A A small amount. I think approximately thirty six hundred dollars.

Q $3600.00 ?

A Yes.

Q The production department actually got back, out of that, sixty-four thousand dollars ?

A That is right.

MR. FENERTY: Mr.Chairman, might I make a suggestion at this time, so that it will be a matter of record, so that I will not be deemed to be acquiescing in the system which is followed in putting these reports before the Board. At the beginning of this Inquiry, the Board suggested, and we all agreed, that while we would not absolutely follow the Rules of Evidence that when reports were going to be submitted, that they would be verified by somebody going into the witness box.

MR.HARVIE: A little louder, please.

MR. FENERTY: I am sorry. The report would be verified by somebody going into the witness box who would be subject to cross-examination. Now, I do not know whether at this time, as far as the City of Calgary is concerned, whether we are interested in several of the reports that have been filed today, but if it is the intention of my learned friend to rely on any conclusions from these reports, particularly this report of Mr. McLellan's, for instance in relation to gathering costs, the percentage of profits that they should have or should not have, then I submit to the Board that they should be withdrawn as far as we are concerned, or, if not withdrawn, should be disregarded because of the technique adopted whereby the essential basic facts which make the reports of any value are not known to the witness.

The report with regard to certain facts starts in the air and the witness starts in the air and we are going into it from there. The Chairman put his finger on the critical part of this report yesterday which, I suggest, renders it of no value and no use. You asked about the prices of this gasoline that the Imperial paid, whether they were competitive. Now, we all know that this high test gasoline has some special values, and it is used in

the Imperial Refinery operations. It appears apparent at once that the price for that gasoline is almost a bookkeeping entry, similar to what it would be as between two Departments, the difference being that it is between a controlled subsidiary and its principal, and has no relation to competitive costs, such as importation of that particular product to the Imperial Refinery. The basic price in comparison with the competitive costs might increase these profits some three or four times, and it would not be just an increase in proportion to the increase in price, because your cost would be greater.

I say that without these basic facts, without getting at the basic facts, any conclusion as to what the percentage of profits would be, without knowing what the competitive price would be for the product, has nothing to do with the case, and I submit that in reports of that kind, that my friends must, either through this witness or through somebody else, submit the basic facts that we can test.

Again today we had the question of depreciation, just to cite two things, depreciation of this item of $180,000.00, and the witness admits that if that cannot be put to some use it should be written off at a certain time, and if it can be, it could not be written off, in reply to my friend, Mr. Blanchard. In other words, he says that he does not know the basis for depreciation. Well, if he does not know, it should not be worked out. The technique we are being confronted by now is by the witness verifying the point by starting in the middle and then starting to go back, and whether that is sound or not, I do not know.

MR. CHAMBERS: Mr. Chairman, in the first place I must state that this statement has been prepared primarily in connection with the function that the Board has under this

Act to fix the percentage of the realization on the product of this plant which the producer has to get. Now, I submit, with utmost respect, that it is none of my friend's business. If he wants to get any comfort from it or attack it, he can. That is all right. I am not concerned with whether it is of any use to him or otherwise in the other part of the Hearing.

MR. FENERTY: Now, I agree with my learned friend, and I will put it on the record, that the only reason that I said what I did was with regard to any deduction with reference to the distribution of gathering costs. He said that it is primarily on the other and it is none of my business and has nothing to do with the gathering costs, and if that is so, I am satisfied.

MR. CHAMBERS: Because I say that the gathering costs should not be fixed on the basis of profit.

MR. FENERTY: I am satisfied.

MR. CHAMBERS: But I want to make my position clear, If I see fit later on to refer to anything in this record on any part of this Hearing, and if the Board thinks it is of any value, I am going to use it.

MR. FENERTY: Well, you do not mean what you said three minutes ago.

MR. CHAMBERS: Yes, I meant what I said.

MR. FENERTY: I have got my objections on the record. That is all I wanted.

THE CHAIRMAN: It is clear to me that this submission made by Mr. McLellan is quite incomplete for the reason that he is unable to answer questions on cross-examination, questions that are proper questions, unless you intend to put another witness in the box to supplement his evidence.

MR. CHAMBERS: That brings up another point again. I

submit that there is not an accountant or one man that you can put into the box that can give a truthful answer with knowledge of a type to answer all the questions that are put to him. Now, if I can get the information which I think is of benefit to this Commission, or of benefit to my clients, I will put it forward. If my learned friends want some of this information, I do submit that they should put somebody on the stand and give some of it, because I submit it is not incumbent on me to supply information to everyone that wants information.

THE CHAIRMAN: On the other hand it is not incumbent upon me to direct you to produce the evidence upon which I can adjudicate, and Mr. McLellan in his evidence today is quite incomplete. He was asked questions which were perfectly proper questions and he said, "I do not know".

MR. CHAMBERS: Certainly.

THE CHAIRMAN: The answers to those questions might be very vital.

MR. CHAMBERS. They might be.

MR. HARVIE: There is just one question I might ask.

THE CHAIRMAN: Yes.....

.....

CROSS-EXAMINATION BY MR. HARVIE

Q Mr. McLellan, do you know whether the price for the gasoline product is under the control of the Wartime Prices and Trade Board, and has been set by them?

A No, I do not.

Q You do not know whether it is or is not?

A No, I do not.

EXAMINATION BY THE CHAIRMAN

Q THE CHAIRMAN: Do you know if Imperial Oil buys natural gasoline from any other company?

A No, I do not.

Q Do you know the prices they pay for it and the price they pay Royalite for the natural gasoline they buy?

A Well, I think there are four different types of product which I think are paid for, and I think the main product, and I am just guessing at it on this, is $2.28 a barrel or $2.29 a barrel.

MR. McDONALD: Mr.Chairman, I would ask Mr. McLellan to provide me with some information with regard to the residuary assets of #2 plant, and the #2 compressor. I think he is preparing that for me. I have also asked him to provide me with a statement of the depreciation account as booked of the assets comprised in #1 plant and #2 plant, and the auxiliary plants, as referred to in his report. I believe he has arranged to get that ready for me.

MR. CHAMBERS: Well, I submit they are not strictly relevant, and by producing them I am not admitting their relevancy. If anybody is entitled to see them, I submit it is the producer, and if Mr. McLellan has them here, we are willing to produce them.

THE CHAIRMAN: I am very glad, because I certainly would like to see the factual as well as the theoretical material.

Q When will that be ready, Mr. McLellan?

A What is today, today is Thursday.

Q Yes?

A When should they be ready?

Q It is not that. We will be sitting next Monday and Tuesday,

A I think I could have them by Monday, yes sir.

Q All right.

MR. McDONALD: Now, if there is anything else I would like to have, I will let Mr. McLellan know. In the meantime I would like to stand over my cross-examination until Mr. McLellan comes back into the box with those statements.

Q THE CHAIRMAN: Mr. McLellan, I would like you to read the transcript between now and Monday, and in those cases where you said "I do not know", I want you to make inquiries of those who do know and be ready, if possible, to answer the questions that you could not answer yesterday and today.

A May I express an opinion there, Sir? I think some of those were engineering questions, and if I might give an answer then somebody may ask some other questions.

Q I am not blaming you for saying you do not know; if you do not know that is the proper thing to say.

A What I am getting at is, if I am questioned on the engineering question, and if I answer that might bring another point up.

MR. CHAMBERS: I am quite prepared to have Mr. McLellan get all the information anyone wants. If there is something of an engineering nature, rather than have Mr. McLellan make an inquiry and come in to give it, I might serve the Board better by putting an engineer in, because I think evidence of that kind should be tested by cross-examination.

MR. FENERTY: The same as in some of the other things.

THE CHAIRMAN: That is all right, Mr.Chambers, if Mr. McLellan comes back with engineering information, I know where he would get it, and I have a very high respect for it.

Now, is there anything else for Mr. McLellan today?

Thank you in the meantime, Mr. McLellan.

.....

EARL C. SMITH, recalled, already sworn, testified as follows:

THE CHAIRMAN: Are you still in the same position, Mr.Steer, no cross-examination of Mr.Smith?

MR. STEER: I have a few questions, yes sir.

.....

CROSS-EXAMINATION BY MR. STEER

Q Your figures in this Exhibit 158, I understand, are based on 353 billion of a reserve?

A As at January 1st, 1944.

Q As of the 1st of January, '44?

A Yes.

Q If by any chance the actual amount of gas to be put through this plant should be substantially less then your figures would be entirely out of line?

A I do not know that they would be entirely out of line for this one year.

Q Pardon?

A I do not know that they would be entirely out of line for this one year.

Q You say they might be in line for one year, but over the long period?

A It would not be entirely out of line, I am saying.

Q I really do not know what you mean?

A They would be substantially the same if it is one year, for this one year, 1945, for any change that we can see at the

present time anyway.

Q Yes. We will assume if, by reason of some accident or by reason of a change in the market situation or by changes made say, for example, by the Home Oil Company withdrawing its gas, and that we have got, instead of 353 billions we have got only say 200 or 250 billions of a reserve, and, having that in mind, I ask you to put your mind forward for a period of say five years?

A Well, I would put it this way, I think that no matter what reserve we took, it is going to be subject to change in five years, putting my mind ahead.

Q Yes.

A We are going to have these reserves changed from time to time possibly.

Q Well, assume that in five years' time we realize that the reserves are only 200 billion instead of 353 billion?

A We would have to accelerate.

Q And you have made your computations today on the basis of unit depreciation?

A That is right.

Q That is right?

A Yes.

Q And then it is realized in five years' time that a mistake has been made of taking too large a reserve and you have not taken enough depreciation?

A That is right, we would have to accelerate the depreciation later on if our reserves are considered in five years' time, subject to change.

Q So that it is a matter of very great importance to see that the reserves are very conservatively estimated, that is right?

A I believe that is right naturally, but to be exact, it would

be much better, were you to get it exact and not conservatively.

Q I guess that is a little difficult?

A Yes.

Q And we made a mistake in reserves and we discover over five years, in five years' time, within that period, then for that period the rate base is larger than it should be?

A No, I do not think that would be the case. If we have taken too much depreciation off our rate base would be decreased.

Q It is smaller?

A Yes.

Q I see. Then, that being so, the return on the dollar invested is what?

A Would partially offset the extra depreciation that would have to be charged. In other words, at the end of five years our return would not be quite so high, and our depreciation would have to be accelerated greatly. One would tend to offset the other, not necessarily equally, but in that direction.

Q I see. Now, in your Schedule 3 you have a rate base there of $2,527,181.24. Now I take it that is one of Mr. Hill's original figures?

A That is right, that is one that we originally set up. I believe I mentioned that on Page 2.

Q Yes. And you show there a return of 5.13814, a deficiency rather of 5.13814% below your 15.83333%?

A That is correct.

Q That is correct?

A Yes.

Q Reduce the amount of the rate base, charge a much greater share of the gathering and compressing costs, and the gasoline business, cut out the Girbotol royalty, and the picture would be entirely different.

A I would be forced to say "Yes " to that.

Q I would think you would. Yes.Tell me about that Girbotol royalty, it ceases, I understand, in 1948?

A I am not sure of the year, but that is my understanding, around there somewhere.

Q It endures for the life of the patent?

A That is right.

Q And the patent, I think, expires in 1948?

A Yes.

Q And if there is anything wrong with the suggestion, perhaps you will let us know.

MR. CHAMBERS: That is right.

MR. STEER: That is right?

MR. CHAMBERS: Yes.

Q MR. STEER: Are you able to tell us to what extent the operating costs are going to vary with the amount supplied to the Canadian Western market? I suppose, for example, your figures are given on the basis of, I think, 16 billion?

A Yes, that is for 1945.

Q Now, we will suppose that the figure diminishes so that it comes down to 12, you are only supplying three-quarters of what you did before, to what extent do your operating expenses diminish in proportion?

A No, I can't tell you in direct proportion.

Q Could you give us any rough idea? Perhaps I will put it this way, what are the operating expenses which will be decreased with a diminishing supply of market?

A That is a hard question to answer definitely, but I would say it would be the oil, the lubrication, chemicals, steam, electricity

and power.

THE CHAIRMAN: The gas purchased?

A Well that was not considered as part of the operating expenses. Yes, the gas purchases on the other end of it, they would be in direct proportion, of course, as well as the sales.

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Q What would be the direct proportion - perhaps we can get it that way, of gas purchases to that ?

A Gas purchases would be -

Q And depreciation would be in direct proportion ?

A Yes.

Q Because your depreciation is on a unit basis ?

A That is right, yes. They would.

Q And anything else that would ?

A I would not like to say. Maybe lubricating oils and chemicals.

Q If you would like to think it over I think it might be helpful if we had an answer to that question and Mr. Chambers thinks it wise to let you do so and let us have the information.

MR. CHAMBERS: I would say in the first place it is an engineering problem and I think you should put those questions to an engineer. I think when an accountant is asked in the box a question that properly is in the field of some one else he should not necessarily have to inform himself and engineers have been in the box.

MR. McDONALD: I think that is in the record in M-9.

MR. STEER: I think that is all.

MR. McDONALD: I have no further questions.

THE CHAIRMAN: Mr. Harvie ?

MR. HARVIE: No questions.

THE CHAIRMAN: Mr. Fenerty ?

MR. FENERTY: No.

CROSS-EXAMINED BY MR. BLANCHARD:

Q I have one question of Schedule 3 of Exhibit 158. You say the adjusted gross profit before income tax is so much and it should be you say $2,527,181, multiplied by 15.83% return ?

A Is it the wording that is objected to ?

Q Beg pardon ?

A Is it the wording you are objecting to, "it should be."

Q Well I object to that. I do not agree with it: I am open to persuasion but I just wanted to know how you made up your $2,527,181 ?

A Well I think on page 2 it would explain that in the long statement. We take the gross fixed assets as shown by Messrs Ford Bacon & Davis' report. I believe it is Exhibit 59.

Q Perhaps I can give you the figures and you might check with me. The Ford, Bacon & Davis appraisal before adjustment was $2,538,240.42. Have you those figures ?

A No, I have not. That would be the net figure I am to take, is it ?

Q That is I think.

A After depreciation has been taken off ?

Q No. No.

A If I remember right I think it was two million nine hundred some odd thousand gross.

Q Perhaps we had better check them with you and make a little statement just to reconcile this figure of yours with the facts. Possibly, sir, we need not keep everyone here while we check them and they can be put in as the agreed reconciliation that is the figure or you can give it to me.

A I think I can give it to you now.

Q All right then if you can give it now.

A On Page 22, Exhibit 59 Mr. Hill's total new valuation was $2,958,216. From that we have deducted for this purpose here the going value and we have not set that up on our books and there was a slight adjustment of ten thousand some odd dollars.

I have not that exactly for the Girbotol royalty. He shows one figure. Our figure is $19,725.84, so that makes an adjusted gross value of $2,747,966.26. We have deducted the depreciation, that is the observed depreciation shown by Mr. Hill as of January 1st, 1944 of $468,113.35. We have added on the 1944 additions, $359,523.00. We had to subtract the 1944 depreciations, $106,234.20; have to add on 50% of the 1945 additions, considering all the additions were made as of July 1st 1945, $56,039.70. We have also deducted 50% of the 1945 depreciation of $62,000.17, leaving a total capital employed for 1944 of $2,527,181.24.

Q As of June 30th, 1945 ?

A That would be correct, yes.

Q MR. CHAMBERS: That includes working capital. Mr. Hill's figure had working capital ?

A That includes the $190,000.00 working capital and I believe that agrees with this figure you quoted before in Schedule 2 of $2,527,181.24.

CROSS-EXAMINED BY MR. STEER:

MR. STEER: May I ask one more question ?

Q I apparently had not learned my lesson very well and I did not make my questions to you quite as clear as I should have done. I am going to ask you for example to assume an historical cost of one million dollars and that we have got a reserve estimated at two hundred billion feet and of that two hundred billion feet fifty billion have been consumed as at the time when you were fixing your rate base. I take it you would agree that our rate base under those circumstances would be $750,000.00. We have used up a quarter of our supply and have started out with $1,000,000.00 and have applied the unit method of depreciation to that and we should start with $750,000.00.

Would that be right ?

A I would not consider it right. That is one way of looking at it.

Q But what is wrong with it ?

A You are going back on the unit method depreciation prior to the Board taking over jurisdiction.

Q I understood all your figures are based on the unit method of depreciation ?

A Since 1944.

Q I see.

A We have used the observed depreciation which was given by Mr. Hill prior to 1944.

Q I see. Well then if you will take my assumption and use unit depreciation from the beginning, then $750,000.00 would be the correct figure for our rate base on that assumption ?

A On that assumption, yes. On that assumption.

Q Then suppose in five years time we have got to revise our reserves downward and we discover that instead of the two hundred billion we started with we have only one hundred billion ?

A That is one of the objects we have in taking the unit method of depreciation of valuation at first.

Q Then that means that when we fixed this $750,000.00 we really should have fixed $500,000.00 as the depreciated rate base ?

A You decrease by $200,000.00 to something less in your assumption.

Q Yes.

A Yes, that is right, it would be less.

Q We have reduced it by $200,000.00. That is what we should have been calculating right from the beginning ?

A Yes.

Q So on that phase the suggestion I made at first is correct ?

A Yes, that would be correct. It could work either way.

THE CHAIRMAN: Anything further. Now we will only be sitting two days next week, Monday and Tuesday and I do not know what is arranged.

MR. HARVIE: Mr. Chairman, Mr. Donellan will be here for those two days and we could ask him to give evidence Monday morning or Tuesday morning.

THE CHAIRMAN: Well I am going to suggest that as we have only two days next week we sit two and a half hours in the morning and two and a half hours in the afternoon which will pretty near give us our equivalent of three days and we will as usual accommodate a witness who is from out of town.

MR. STEER: I was rather expecting Mr. Chairman, word of what we are going to receive in the way of statements from the B. A. Company and when we are going to receive them.

THE CHAIRMAN: With relation to the absorption plant ?

MR. STEER: Yes.

THE CHAIRMAN: And the evidence that Mr. Donellan is going to give ?

MR. STEER: Yes.

MR. HARVIE: Mr. Chairman, the situation is that by arrangement that phase of the enquiry is being adjourned sine die on the basis that we did give the information to those parties we thought were interested in that phase and that is the producers. I do not believe that the Gas Company are interested in that phase, nor the City, and on that basis I have not supplied them with that information.

THE CHAIRMAN: I do not think that is quite accurate,

Discussion.

Mr. Harvie. You asked for an adjournment of the absorption plant phase of the B. A. so that you might attempt to negotiate a settlement with the producers in the south end. I have intimated to you that I would either expect you to tell me you have made a settlement or be ready to go on on the 25th of this month.

MR. HARVIE: I think that is correct. And if on the 25th, we have not made a settlement then the question arises as to who are the proper parties to receive the statements.

(Go to Page 6059)

THE CHAIRMAN: I have already said I do not know where to draw the dividing line and I am satisfied that no Counsel here can tell me where to draw the dividing line between the absorption plant, the Natural Gas company and the City. I am going to permit Counsel to participate in the absorption plant inquiry and to enable them to do so they should have the same statements that are given to the other parties.

MR. FENERTY: I am just wondering if my friend's position is the same as that of Mr. Chambers', that it is none of our business, but if there is anything that can be used against us, it will be used.

MR. CHAMBERS: It is my submission.....

MR.HARVIE: Then do I understand so far as the absorption plant inquiry is concerned, that is that part of the inquiry that comes within specifically 72, 3 and 4.....

THE CHAIRMAN: Whatever the number of the Section is that authorizes us.

MR. HARVIE: You are directing us that we supply that information to parties that we consider are not interested in it?

THE CHAIRMAN: Yes, certainly. Very definitely, in fact.

MR.HARVIE: And if we ask for it I presume you will give an Order to that effect?

THE CHAIRMAN: No, I am simply giving you a direction now. I am not going to make a written Order in the middle of an inquiry.

MR. HARVIE: I think that has been done under somewhat similar circumstances as to whether the matter is relevant in this inquiry. If it is purely an absorption

plant inquiry that is one thing, but if it is in the Gas inquiry as such, that is another thing. So far we propose to make a submission, and in making that submission file the historical facts and records in the Gas Inquiry, and that is what Mr. Donellan will be here for at the beginning of the week.

THE CHAIRMAN: All right, do exactly and precisely as you please, but you may regret it before you are through. You are not going to dictate to me how I am going to run this hearing, Mr. Harvie.

MR. HARVIE: I do not wish to, Mr. Chairman, at all. There is no suggestion that I do that.

THE CHAIRMAN: You have heard my direction, and I will expect you to comply with it.

MR. McDONALD: Just one thing. I agreed some time ago to file copies of certain judgments of the Public Utilities Board. I have those copies made, certified copies, and I will just hand them in. I think they have already been marked.

MR.BLANCHARD: They have been marked?

MR. McDONALD: Yes.

MR.BLANCHARD: Do you remember the Exhibit numbers?

MR. McDONALD: No, I don't.

(At this stage the Hearing was adjourned until 9.30 A.M. Monday, March 18th, 1946).